

The year 2002 was one of the most special ones for Estonia since the restoration of independence. The goal that has largely determined our development – membership in the economically and organisationally powerful European Union and the world's most powerful defence organisation NATO – became a reality. Our planned, consistent and successful activity in achieving this goal was acknowledged by the EU authorities with a suitability mandate and conclusion of accession negotiations and an invitation to membership talks by the NATO.



On 16 April 2003, the current and future EU Member States, Estonia among them, signed the enlargement treaty in Athens. Although the membership referendum is still ahead in Estonia, I believe that the outcome will not differ from the positive answer of the three nations that have already had the plebiscite.

The 2002 report of Eesti Pank discusses at length the central bank's efforts in making Estonia a worthy partner to the current EU members. Here I would like to emphasise once again that it is neither right nor justified to regard the forthcoming accession to successful European countries as a comprehensive aid programme. True, cooperation with partners with strong economy and vast experience in market economy will accelerate our development as well. Close contacts with the EU member countries have already given important impulses to Estonia's economic development. However, the support of European industrial countries has not been expressed in money terms alone and it would be short-sighted to weigh benefits of the EU only on the size of financial subsidies. The actual and permanent benefit of the membership will become apparent when we manage to take

advantage of the new opportunities – and offer positive experience of our own to the so-called old members. The possibilities for this are there. For example, we are not burdened with the need to start reviewing the decades-old system of benefits and guarantees in the changed economic and demographic situation. Estonia as a small country that started almost from scratch has a good chance to show how the possibilities of modern information technology and biotechnology are being used, how a country can advance even without great strength, but a lot of ingenuity.

What were the most important developments of 2002 from the point of view of the central bank?

Last year brought remarkable changes in the international environment of Eesti Pank's activities. First opportunities to participate in designing EU decisions and policies have been opened up and preparations for real cooperation in the framework of the European System of Central Banks have gained momentum. Cooperation with the International Monetary Fund reached a new level and collaboration with other international institutions and central banks became tighter.

In 2002, economic development was controversial and unpredictable in many respects. Although the growth of the world economy as a whole stabilised and even accelerated, the pace was not as fast as the forecasts had predicted. The economic environment of Estonia's major trade partner, the European Union, was even the worst of the recent years for us. Nevertheless, the adjustability of the Estonian economy and the financial sector was remarkably good in the conditions of relatively weak global economy: our economic growth was four percentage points above that of the euro area and inflation was low. Investments increased considerably, but the level of domestic saving declined, particularly in households. This led to the increase of the current account deficit, which was covered by the earlier accumulated reserves and additional foreign loans. The negative external effects on our economy were neutralised, first of all, by the strong financial sector and balanced budget. By credit rating, Estonia is still among the top three most reliable EU accession countries.

At the same time there were also some worrying developments in our financial sector in 2002 – first of all overly optimistic borrowing. Therefore, the central bank, the government and the Financial Supervision Authority took joint action in order to draw wider attention to the risks related to borrowing. Taking out a bank loan is, of course, a normal activity. But our aim was to point out that, due to the weak economic growth of the euro area interest rates in both the euro area and Estonia were unprecedentedly low in 2002. In Estonia, loan conditions were also influenced by the strong competition between banks. However, when the circumstances change and the GDP growth in the European industrial countries increases, loan rates will go up as well. Therefore, no private borrower should overestimate his or her possibilities due to the currently offered favourable terms.

If we look at it as a separate economic indicator the loan burden of the government is not large in Estonia. But given the smallness of our country, the heavy loan burden of the private sector should not be overlooked. Combined, these two indicators point to a loan burden that is not so small after all.

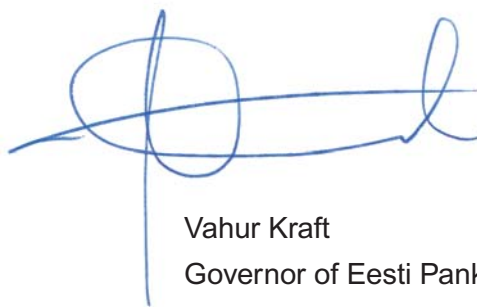
The year 2002 was very important for developing the safety net of the Estonian financial sector. In supervision, a new level of quality was achieved, as the unified Financial Supervision Authority completed its first year. Today, we can say with certainty that the establishment of this institution at the central bank was the right decision and its synergetic effect is clearly visible. The reorganisation of the Deposit Guarantee Fund into the Guarantee Fund and creation of its three sub-funds extended the protection of depositors also to small-time investors and holders of pension fund shares.

The implementation of the new settlement system was an important step for speeding up interbank payments and formed a good basis for joining the Trans-European Automated Real-time Gross Settlement Express Transfer system TARGET in future.

2002 was successful for Eesti Pank also economically. The yield of foreign exchange reserve investments exceeded expectations by more than two times. However, this was partly due to somewhat exceptional developments in financial markets – stock markets

declined and demand for government bonds increased, global growth was slower than expected and geopolitical risks increased. Thus, the central bank might not achieve similar financial results every year.

For ten years now Estonia has followed the monetary policy principles adopted in 1992. These will not change until Estonia joins the European Economic and Monetary Union. This is the most suitable approach for Estonia. The fixed exchange rate and the currency board framework have proven themselves convincingly in Estonian conditions over the past decade. However, the stability of the exchange rate and usefulness of the fixed rate depend directly on the flexibility of the economy to survive serious shocks if necessary. This dependence also applies to Estonia. Our currency board system and fixed exchange rate have endured and supported economic development because Estonia as a whole has pursued sound economic policy over the past decade. Today, when EU membership is less than a year away and changeover to the euro, the common currency of the European Union, is not in the too distant future, maintaining sound economic policy in the coming years has become more important than ever before. Economic decisions demand moderation from all of us. The choices we make today will largely determine our development in the European Union.

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke, positioned above the name and title of the signatory.

Vahur Kraft  
Governor of Eesti Pank